Supreme Court, U.S.
FILED
JAN 29 2003
OFFICE OF THE CLERK

(2)

No. 02-1016

In the Supreme Court of the United States

LEE M. TILL AND AMY M. TILL,
Petitioners,

v.

SCS CREDIT CORPORATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

PETITIONERS' SUPPLEMENTAL BRIEF

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Petitioners file this supplemental brief in support of their Petition for Writ of Certiorari to demonstrate how the Sixth Circuit Court of Appeals decision in *In re Kidd*, 2003 U.S. App. LEXIS 188 (6th Cir. 2003) (App. H at 82a) entered January 8, 2003 deepens the split amongst the Circuits and raises new questions regarding the continued validity of several Circuit decisions that had misconstrued early Sixth Circuit precedent. Because the Sixth Circuit was the first Circuit to adopt a "coerced loan" approach, all subsequent "coerced loan" Circuits were influenced to some degree by what the Sixth Circuit in *Kidd* exposes as an improper expansion of the "coerced loan" and "market rate" concepts.

MOST RECENT CIRCUIT DECISION ADDS TO CONTROVERSY

I. Sixth Circuit in *Kidd* Clarifies That "Market Rate" Concept Was Never Intended to Require Fact-Specific Inquiry Nor Contract Rate of Interest in Cramdown Context

Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427 (6th Cir. 1982) was the first Circuit Court opinion addressing the methodology for determining the cramdown interest rate under 11 U.S.C. § 1325(a)(5)(B)(ii). According to the Court in *Memphis Bank,* the creditor under the cramdown statute makes a new or coerced loan to the debtor in the amount of the current value of the collateral, and the most appropriate interest rate is therefore the current market rate for similar loans at the time the new loan is made. In so ruling, the Court in *Memphis Bank* provided little practical guidance to courts in determining how the appropriate "market rate" should be determined.

The decision of the Sixth Circuit in *Kidd* required interpretation of what the Court considered the "controlling case" of *Memphis Bank* (App. H at 83a). The debtors'

contract for purchase of a used vehicle in *Kidd* provided for payment of interest at the rate of 20.95%, as compared to the 8% rate of interest proposed by the debtors' Chapter 13 plan (App. H at 85a). Creditor Household Automotive Finance Corporation submitted evidence of its status as a "subprime" lender, and testimony that the debtors would not qualify for an interest rate of less than the 20.95% contract rate as a result of their poor credit standing. The bankruptcy court instead accepted (as credible evidence of "market rate") the testimony of a local bank president who testified to a weighted average rate of interest of 9.3% for all car loans (both new and used vehicles for all tiers of borrowers) (App. H at 86a). Although the bankruptcy judge found from the evidence presented that "the current market rate for similar loans in the region is 9.3%," the bankruptcy court fixed the rate to be applied to the Kidds' loan at 10.3%, as a result of a recent rise in interest rates (App. H at 87a). In upholding the bankruptcy court's determination, the Court of Appeals concluded that the proper rate of interest to be applied in a Chapter 13 cramdown is:

> ...the current conventional market rate used for similar loans in the region, and not necessarily the contract rate. Such a determination does *not* entail an analysis of any particular debtor's credit rating but rather involves a more objective determination of the value of money over time so as to compensate a creditor according to the present value of its secured claim.

(App. H at 96a) (emphasis added).

Household relied upon the early Sixth Circuit case of *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989), where the Court of Appeals, interpreting *Memphis Bank*, held that

"where a 'cramdown' occurs..., a creditor is entitled to *its* current *market rate* on the 'new loan'" (emphasis added). 878 F.2d at 930. Household contended that the Court's reference to "its market rate" in *Arnold* mandates fixing of interest at the rate at which a loan would be made by Household as a "subprime" lender to borrowers with poor credit standing identical to that of the debtors in *Kidd*.

The Court of Appeals in *Kidd* firmly rejected the fixing of a rate based upon such a creditor-debtor specific inquiry as follows:

> In fact, adoption of such a rate is tantamount to endorsement of the automatic application of a contract rate of interest, a principle clearly at odds with the clear language of *Memphis Bank & Trust*. Rather, it is more likely that use by the panel in *Arnold* of the modifier 'its' to describe the appropriate market rate was intended solely to limit consideration to rates relevant to the particular *types of loans* at issue. For instance, the setting of the market rate for automobile loans should be limited to consideration of only the automobile loan universe and not rates that would apply to an average borrower seeking, for instance, financing for a new home.

(App. H at 92a-93a)(emphasis in original).

The *Kidd* case is thus significant in two key respects. First, the Court of Appeals in *Kidd* finally dispelled the notion that the Sixth Circuit in *Memphis Bank* and *Arnold* intended application of a fact-specific interest rate that can be determined only on a case-by-case basis from information specific to a particular debtor or creditor. Second, the Court of Appeals in *Kidd* flatly rejected the creditor's contention

that *Memphis Bank*, *Arnold,* or *In re Colegrove*, 771 F.2d 119 (6th Cir. 1985), provide support for application of the contract rate of interest on an undersecured creditor's claim in the cramdown context.[1] The Sixth Circuit in *Kidd* recognized that application of "present value" payments by use of a discount factor does not derive from any state-law "contractual" obligation, but results instead from a statutory adjustment for the "time value of money" due simply to the debtors' deferred payment.

II. *Kidd* Decision Calls Into Question Continued Viability of Numerous Circuit Decisions Which Have Misconstrued Sixth Circuit Precedent

Because *Memphis Bank* was the first Circuit decision to adopt a "coerced loan" approach, most, if not all, subsequent Circuit decisions adopting a "coerced loan" approach can be traced back to the *Memphis Bank* decision -- and to what has now been exposed by the Sixth Circuit as an erroneous construction of that and subsequent Sixth Circuit cases.

The majority panel in *Till* patterned its decision after the Third Circuit decision in *GMAC v. Jones*, 999 F.2d 63 (3rd Cir. 1993). *Jones*, in turn, adopted *Memphis Bank* as the

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[1] The Court interpreted the *Colegrove* case to be strictly limited to the facts of that case involving a completely secured home mortgage arrearage. The *Colegrove* case was subsequently superseded by enactment of the Bankruptcy Reform Act of 1994 and 11 U.S.C. § 1322(e), which limits the circumstances under which interest can be required to be paid on mortgage arrearages cured under a Chapter 13 plan. Cases relying upon *Colegrove* as grounds for imposition of contractual interest under the cramdown statute have thus been abrogated by statute.

pivotal case in which the "Sixth Circuit ... stated tersely ... the basic idea of the 'coerced loan' theory." 999 F.2d at 67-68. The Sixth Circuit's narrow interpretation of the *Memphis Bank* decision in *Kidd* to preclude a presumption in favor of the contract rate lies in sharp contrast to the Third Circuit's expansive interpretation in *GMAC v. Jones,* where the Court of Appeals adopted the contract rate presumption by erroneously interpreting *Memphis Bank* to require that present value be determined from facts specific to the creditor. According to the Court in *GMAC v. Jones:*

> ...the appropriate rate is that charged by the particular creditor forced to extend credit. If that creditor receives interest at a rate equal to the rate it charges in the regular course of its business in the region for loans of similar character, amount and duration, that creditor will be placed in approximately the same position it would have occupied had it been able simply to repossess the collateral at the time of the bankruptcy.

999 F.2d at 68, citing *Memphis Bank*, *supra*, 692 F.2d at 429.[2]

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[2] In stark contrast to *GMAC v Jones'* reading of *Memphis Bank* to focus on a particular creditor's return on its investment, the Sixth Circuit in *Kidd* makes clear that the *Memphis Bank* "market rate" analysis instead contemplated an "objective" determination of the "value of money over time" so as to compensate a creditor for the "present value" of its secured claim (App. H at 96a) -- a clear directive by the Court of Appeals to shift focus away from the creditor's profit and lost opportunity costs back to the language of the cramdown statute.

The effect of misapplication of the decades-old *Memphis Bank* case has been far-reaching. Virtually all courts adopting a "coerced loan" approach prior to *Kidd* interpreted *Memphis Bank* and its progeny to require a creditor-debtor-specific inquiry with focuses upon the creditor's return on investment. A common description of the "coerced loan" approach from *Koopman's v. Farm Credit Services of Mid-America, ACA*, 196 B.R. 425 (N.D. Ind. 1996), *aff'd*, 102 F.3d 874 (7th Cir. 1996), gives some indication of the number of Circuits whose decisions are undermined by this common misconstruction of *Memphis Bank* and its progeny:

> ....Under [the coerced loan] approach, the bankruptcy court should look at the *creditor's cost of making a new loan to the debtor* in the amount of its allowed claim, *including a profit factor*, and use the current market rate for similar loans (loans of similar character, amount and duration) made in the region. *See General Motors Acceptance Corp.*, 999 F.2d at 67-70; [] *United Carolina Bank v. Hall*, 993 F.2d at 1130-1131; *In re Fowler*, 903 F.2d at 698; *In re Hardzog*, 901 F.2d 858, 860 (10th Cir.1990); *United States v. Arnold*, 878 F.2d 925, 930 (6th Cir.1989); *United States v. Neal Pharmacal Co.*, 789 F.2d 1283 [] (8th Cir. 1986); *Matter of Southern States Motor Inns, Inc.*, 709 F.2d 647, 651-652 (11th Cir. 1983), *cert. denied*, 465 U.S. 1022, 79 L.Ed.2d 680, 104 S.Ct. 1275 (1984); *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427,431 (6th Cir. 1982).n9

196 B.R. at 427-28 (emphasis added) (footnote omitted).

Similar misinterpretations of *Memphis Bank* and *Arnold* can be found throughout the "coerced loan" Circuits. Thus, the Fourth Circuit in *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993), citing *Memphis Bank* and *Hardzog*, *supra*, concluded that the value of the collateral retained by the debtor under the Chapter 13 cramdown provision must be treated as a new loan which must "match its rate of return to the secured creditor with that which the creditor would otherwise be able to obtain in *its* lending market." 993 F.2d at 1130 (emphasis added).

Those Circuits (like the majority below) adopting a presumption in favor of the contract rate of interest have carried this misconstruction to an extreme. Thus, the Fifth Circuit in *Matter of Smithwick*, 121 F.3d 211, 213-14 (5th Cir. 1997) cited the above language from *Memphis Bank* and relied upon *United Carolina Bank v. Hall, Hardzog*, and *GMAC v. Jones* in adopting the Third Circuit's "coerced loan" approach of a rebuttable presumption in favor of the contract as the rate most consistent with what a particular secured creditor would charge for a loan similar in character, amount and duration to the "credit" extended to the debtor under the plan.

By imposing a "subprime" lender's contractual rate of interest as the presumptive cramdown rate under the guise of the "coerced loan" theory, the majority panel in *Till* and the Courts in *Smithwick* and *GMAC v. Jones* have created a stringent requirement for confirmation that was neither foreseen by the Court of Appeals in *Memphis Bank*, [3] nor sanctioned by the Bankruptcy Code.

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[3] Recall that the Court of Appeals in *Kidd* rejected the automatic application of the contract rate of interest as "a principle clearly at odds with the clear language of *Memphis Bank & Trust*." (App. H at 92a-93a).

III. Sixth Circuit in *Kidd* Leaves Many Questions Unresolved

The *Kidd* case is important in clarifying that the "coerced loan" theory as first enunciated in *Memphis Bank* was never intended to address a particular creditor's status as a "subprime" lender, or a particular debtor's poor credit rating. Yet, in having to work within the confines of the "coerced loan" theory, there are many questions that the Court of Appeals in *Kidd* could not adequately resolve.

The Court of Appeals in *Kidd* wholly fails to address the fact that the conventional bank loan (which served as the basis for the rate adopted by the Court) would necessarily include the costs of a new loan transaction [not incurred under § 1325(a)(5)(B)(ii)], as well as profit earned in a conventional bank loan transaction (inapplicable to the statutory "present value" inquiry).

Although the Court of Appeals in *Kidd* thus went a long way in attempting to limit the damage that has occurred through improper extension of the "coerced loan" theory, the Court could not go far enough as a result of the "precedential deference" it was constrained to accord *Memphis Bank* and its progeny (App.H at 96a). The Court in *Kidd* thus presumed from *Memphis Bank* that a "market-rate" approach was required, and that a "market" existed, despite the fact that nothing in the statute supports the application of a "market-rate" analysis for determination of the "present value" discount factor. The result is an arbitrary application of a conventional bank loan rate that includes improper elements of profit that cannot be reconciled with the statutory time-value-of-money concept.

Nor does the Court of Appeals in *Kidd* address the implications of this Court's intervening decision in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997) seemingly

at odds with the "coerced loan" approach, as a result of the windfall afforded the creditor by payment of an inflated interest rate on the replacement value of the collateral -- based on the fiction of a creditor repossessing its collateral and reinvesting its proceeds. The Court in *Kidd* instead confined its analysis to "[t]he principles of valuation espoused in the case of *Memphis Bank*..." (App. H at 96a).[4]

Constrained by *Memphis Bank's* use of the "coerced loan" theory, the Court of Appeals in *Kidd* attempts to limit the discrepancy between "market rate" and "present value"[5] by interpreting *Memphis Bank* to sanction use of conventional market rates of interest rather than "subprime" rates for high-risk borrowers. But the Court could go no further in exploring whether the use of the conventional bank loan rate with an arbitrary add-on was in fact true to the language of the cramdown statute and the historic concept of "present value."

Nor does the Court of Appeals in *Kidd* address the effect of this Court's intervening decision in the case of *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988), which has been construed to deny payment of interest to undersecured creditors as

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[4] It was unclear what methodology was used by the Court of Appeals in *Memphis Bank* to value the allowed secured claim, which in part resulted in reversal and remand of the case to the bankruptcy court for further proceedings. 692 F.2d at 430-31. The possible effect of use of a *Rash* replacement valuation under the *Memphis Bank* analysis thus remains subject to debate.

[5] The Court in *Kidd* thus avoided the egregiousness of the *Till* analysis resulting in the fixing of a 21% "present value" discount factor, despite the fact that both Courts purported to adopt a forced loan market rate analysis--again demonstrating the serious lack of uniformity inherent in the "coerced loan" approach.

compensation for profit or lost investment opportunities pending receipt of deferred payments under a reorganization plan.

In attempting to conform the present value calculation to the decades-old *Memphis Bank* decision, the Court of Appeals in *Kidd* thus left a string of Circuit Court decisions in disarray, and failed to address intervening decisions of this Court that may significantly affect the cramdown interest rate determination.

CONCLUSION

Petitioners respectfully request that their Petition for Writ of Certiorari be granted to resolve the split between the Circuits that is now more pronounced as a result of the analysis undertaken by the Sixth Circuit in *Kidd*. The fact that so many questions were left unresolved by the Court of Appeals in *Kidd* makes clear that only the Supreme Court can adequately address the issues presented by the *Till* Petition, and reconcile the conflicting analyses of the numerous Circuits to have addressed the cramdown interest rate issue.

Respectfully Submitted,

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APPENDIX H

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 01-5074

[Filed January 8, 2003]

In re: LEWIS KIDD and ROBERTA KIDD, Debtors	)
HOUSEHOLD AUTOMOTIVE FINANCE CORPORATION, Appellant	)
v.	)
BEVERLY BURDEN, Trustee, Appellee	)

Appeal from the United States District Court
for the Eastern District of Kentucky at Pikeville
No. 00-00400
Joseph M. Hood, District Judge

Before: DAUGHTREY and MOORE, Circuit Judges;

SIMPSON, District Judge.*

OPINION

MARTHA CRAIG DAUGHTREY, Circuit Judge. In this bankruptcy appeal, we are asked to review the bankruptcy court's calculation of the appropriate interest rate to be applied in a "cram down" provision in the debtors' Chapter 13 plan. The decision requires interpretation of language in the controlling case of *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427 (6th Cir. 1982). There we adopted what has since become known as the "coerced loan" formulation in the application of 11 U.S.C. § 1325(a)(5)(B), which is the Chapter 13 provision that has been held to permit confirmation of a plan proposed by the debtor over the objection of the holder of a secured claim. Here, the sales contract for the debtors' pickup truck imposed an interest rate of 20.95%, allegedly due to the purchasers' poor credit rating. The Chapter 13 plan proposed a rate of 8%, and the trustee suggested a rate of 10-11%. The bankruptcy court determined that the rate should be 10.3%, an amount that the district court affirmed as reasonable under the circumstances. The creditor now appeals, insisting that in this case only the contract rate will satisfy the valuation criteria of § 1325(a)(5)(B). We reject this contention as a legal proposition and, giving the bankruptcy court's decision what we believe to be the substantial degree of deference required in this context, we find no error and affirm.

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* The Honorable Charles R. Simpson III, United States District Judge for the Western District of Kentucky, sitting by designation.

FACTUAL AND PROCEDURAL BACKGROUND

The relevant facts germane to this dispute are not contested by the actual parties to the appeal, Household Automotive Finance and the Chapter 13 Trustee. Indeed, much of the background evidence adduced at the hearings in this matter was introduced by way of joint stipulation. As noted by the bankruptcy court, the parties agreed upon the following facts:

1. Debtors entered into a Retail Installment Contract and Security Agreement dated May 11, 1999 (the "Contract") under the terms of which Debtors purchased a 1996 Chevrolet C1500 Pickup Truck (the "Vehicle") from Myers Chevrolet-Oldsmobile-Cadillac, Inc. (the "Dealer") for an agreed price of $ 16,827.00.

2. The contract was assigned by the Dealer to Household Automotive Finance Corporation ("Household"), which accepted the assignment.

3. Household has a first and prior lien on the Vehicle by virtue of the Title Lien statement filed in the Perry County Clerk's office on May 20, 1999.

4. Pursuant to the Contract, the balance of the purchase price in the principal amount of $ 14,767, plus interest at the rate of 20.95%, was to be paid by Debtors in 60 monthly installments of $ 399.08.

5. Debtors made two payments under the Contract before filing their Chapter 13 Petition (the "Petition") on August 16, 1999.

6. Debtors filed their Plan along with the Petition under which Debtors proposed to pay 8% interest on the allowed secured claim of Household under the Contract.

7. Household filed its Proof of Claim on September 9, 1999, setting forth a secured claim amount of $ 14,796.85.

8. The value of the Vehicle for purposes of confirmation of the Plan is $ 13,900.

The parties' agreement that the vehicle had a present value of only $ 13,900 thus resulted in Household having a secured claim against the Kidds in that amount and an unsecured claim in the amount of $ 867, which represents the difference between the total amount financed and the value of the collateral. Despite the consensus on the value of the collateral, Household vigorously contested the proposed interest rate to be applied to the payment to the finance company as a secured creditor, arguing that it was entitled to the full 20.95% interest rate rather than the 8% rate proposed by the Kidds. Given that disagreement, the bankruptcy judge conducted an evidentiary hearing at which three witnesses offered opinions as to the appropriate market rate of interest that should be added to the installment payments for the debtors' truck.

David Clayton Cruise, III, the regional sales manager for Household, explained that Household was considered a "subprime" lender because it offered loans to individuals whose past credit problems or lack of positive credit history made them unattractive customers for banks, credit unions, and other "prime" lenders. Due to the higher risk of non-payment from those borrowers, Cruise testified, sub-prime

lenders generally charged higher rates of interest on their loans, ranging from 20.95% to 24.95% for automobile loans. Cruise did admit, however, that Household's website advertised loans at rates as low as 10.95%. He nevertheless insisted that the Kidds, as a result of their low scores on charts predicting creditworthiness, would not be offered an interest rate by Household less than the contract rate of 20.95%.

The second witness to testify at the evidentiary hearing, Richard Newsome, served as senior vice-president and division manager for consumer lending at Community Trust Bank in the Pikeville, Kentucky, area. He explained that the bank rate of interest for a high-risk borrower purchasing a 1996 pickup truck would be 16.25% and the average rate for all used truck loans would be 13.5%. Pursuant to questioning by the Chapter 13 trustee, however, Newsome indicated that a "weighted average" rate for *all* car loans, for both new and used vehicles, and for all tiers of borrowers, would be 9.3% because "99% of those people [in the entire universe of borrowers] pay."

Finally, Michael Litzinger, an attorney in the office of the Chapter 13 trustee, testified that hearings to determine the proper interest rate to be applied in situations similar to the one before the court were seldom required because all parties usually agreed on the application of rates between 10% and 11%. In fact, Litzinger claimed, Household itself had recently agreed to eight different Chapter 13 plans with automobile interest rates of 8% and two plans calling for rates of 10%. The witness concluded that interest rates approved in plans in that area of Kentucky generally ranged from 8-12%. Specifically, he explained:

> Seven percent has almost always drawn objection. Eight percent will on occasion draw an objection and has done so lately because the interest rate in the market is going up in the last year or so. Ten and ten and a half don't draw that many objections. Eleven rarely does and twelve almost never. Some debtors' accounts have 12 for the sole purpose to make sure that they don't get an objection and it's accepted and I think that's why they do that.

Faced with the divergent testimony of the witnesses at the hearing, the bankruptcy judge found the testimony of Richard Newsome, the bank vice-president, believable and determined that the testimony "that the rate of interest for car loans that are made by his bank in the region is 9.3%, is credible evidence of the market rate of interest." The judge specifically found that Cruise's testimony that the market rate of interest is 20.95% "is not entirely accurate," especially in light of the fact that Household advertises rates on the internet as low as 10.95% and has agreed in other Chapter 13 cases to interest rates of 8% and 10%.

Consequently, the bankruptcy judge found "that the current market rate for similar loans in the region is 9.3%," but that, because interest rates had experienced a recent rise, the rate to be applied to the Kidds' loan should be 10.3%. Both Household and the Kidds appealed that decision to the district court, Household arguing that its contract rate of 20.95% should have been used to arrive at the present value of the collateral, and the Kidds contending that no interest whatsoever should be added to the resale value of the pickup truck. The district judge, however, affirmed the ruling of the

bankruptcy court, concluding that the finding of a 10.3% market rate was not clearly erroneous. Additionally, the district court declined to analyze the propriety of the bankruptcy court's consideration of other Chapter 13 plans involving claims by Household, stating that any error in that regard would be harmless because "there is sufficient evidence in the record which supports his conclusion regardless of these agreed orders." Household now appeals from that ruling, availing itself of another opportunity to challenge the conclusion reached by the bankruptcy court.

DISCUSSION

I. Standard of Review

As noted in *Borock v. Mathis (In re Clipper International Corp.)*, 154 F.3d 565, 567 (6th Cir. 1998):

> In reviewing district court decisions on bankruptcy matters, this court accords discretion only to "the original bankruptcy court findings, not those included in the decision rendered by the district court, since 'this court is "in as good a position to review the bankruptcy court's decision as is the district court."'" *In re Omegas Group, Inc.*, 16 F.3d 1443, 1447 (6th Cir. 1994) (citations omitted). The court reviews bankruptcy court findings of fact for clear error and conclusions of law *de novo*. *Id.*

In the present case, not only do the trustee and Household disagree on the interest rate that may appropriately

be charged to the debtors for retention of the collateral at issue, they even disagree on the appropriate standard of review to be utilized by this court in evaluating the bankruptcy judge's determination. The trustee argues that the court's ruling involves only a factual determination as to which of several competing rates most closely approximates market value. As a result, she contends that the ruling of the bankruptcy court should be reviewed only under the clear error standard normally reserved for such factual determinations. *See, e.g., Roach v. United States*, 106 F.3d 720, 723 (6th Cir. 1997) (citing *Anderson v. City of Bessemer*, 470 U.S. 564, 573, 84 L. Ed. 2d 518, 105 S. Ct. 1504 (1985)). Household submits, however, that the issue before the court actually requires selection of the appropriate methodology to be used in making a market rate calculation, and thus entails legal conclusions that are to be reviewed by this court *de novo*. *See id.*

Although, at its basic level, the bankruptcy court decision in this case turns upon a finding that one of a variety of potential interest rates should be considered to reflect true "market value," Household is correct that the court is first called upon to establish for the circuit the *methodology* under which that rate is to be calculated. Consequently, the selection of the appropriate interest rate does indeed involve a legal determination that must be reviewed *de novo* without a presumption of correctness. *See Gen. Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993).

II. "Cram Down" under Chapter 13

Although the Bankruptcy Code nowhere uses the words "cram down," the term has come to denote the confirmation of

a plan over the objection of a secured creditor. Pursuant to the provisions of 11 U.S.C. § 1325(a)(5)(B), a bankruptcy court may approve a plan proposed by a Chapter 13 debtor without the consent of the affected creditor if:

(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.

In *Memphis Bank & Trust Co.*, 692 F.2d at 429, we recognized that the law, in effect, "requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan." (Footnote omitted.) Such interest payments are mandated simply "in order for the secured creditor to get payments over time under the plan having a present value equal to the allowed amount, as the above quoted statutory language directs." *Gen. Motors Acceptance Corp.*, 999 F.2d at 66.

In reference to determination of the appropriate rate of interest to be added to Chapter 13 payments, we declined to "tie the interest rate to an arbitrary . . . rate," and instead held that:

> In the absence of special circumstances bankruptcy courts should use the current market rate of interest used for similar loans in the region. Bankruptcy courts are generally familiar with the current conventional rates on

> various types of consumer loans. And where parties dispute the question, proof can easily be adduced.

Memphis Bank & Trust, 692 F.2d at 431. Even after such a seemingly clear explanation by this court of the proper method for calculating interest in cram down situations, Household now cites additional Sixth Circuit decisions in an attempt to justify its effort to maximize debtor payments to itself to the detriment of other creditors.

For example, the finance company discusses in its brief on appeal the holding in *Cardinal Federal Savings & Loan Ass'n v. Colegrove (In re Colegrove)*, 771 F.2d 119 (6th Cir. 1985). In *Colegrove*, a case arising "in the context of home mortgage arrearages," keith m. lundin, chapter 13 bankruptcy § 112.1, at 112-2 (3d ed. 2000), the court concluded:

> The most equitable rate to establish in this type of situation is the prevailing market rate of interest on similar types of secured loans at the time of allowance of the creditors[']claim and the confirmation of the plan in bankruptcy with a *maximum limitation* on such rate to be the underlying contract rate of interest.

Colegrove, 771 F.2d at 123 (emphasis in original). Household focuses upon that language to support its position that the appropriate interest rates for the automobile transaction in this case should also be determined by reference to "the underlying contract rate of interest." We have, however, limited *Colegrove* to its particular facts -- a home mortgage

arrearage situation in which the creditor "was completely secured and was not required to accept unsecured status as to any portion of its debt." *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989). Because the factual situation in this appeal in no way resembles the facts of *Colegrove*, we conclude that the decision in that case is inapplicable here.

Household also cites the *Arnold* decision in support of its argument that *Memphis Bank & Trust*'s references to "the current market rate of interest used for similar loans in the region" and "the current conventional rates on various types of consumer loans" actually relate only to a lender's own interest rate and not an actual "market" or "conventional" rate. In *Arnold*, we resolved a dispute involving a Chapter 12, rather than a Chapter 13, bankruptcy, but we noted that Chapter 12's cram down provision "is identical to that found in Chapter 13." *Arnold*, 878 F.2d at 927. Then, in determining which of competing interest rates to apply, we held "that where a 'cramdown' occurs . . . and a creditor is forced to write-down a portion of its note, a creditor is entitled to receive *its* current market rate on the 'new loan.'" *Id.* at 930 (footnote omitted) (emphasis added). Household contends that this court's use of the word "its" in describing the relevant market rate indicates that a more general rate need not be considered and that the interest rate at which the particular creditor would loan money to the particular debtor may be used for cram down purposes.

There is, however, absolutely no indication in *Arnold* or in other Sixth Circuit decisions that use of the phrase "its market rate" mandates assessment in this case of interest at the rate at which a loan would be made by Household to borrowers identical to the Kidds in all relevant respects. In

fact, adoption of such a rate is tantamount to endorsement of the automatic application of a contract rate of interest, a principle clearly at odds with the clear language of *Memphis Bank & Trust*. Rather, it is more likely that use by the panel in *Arnold* of the modifier "its" to describe the appropriate market rate was intended solely to limit consideration to rates relevant to the particular *types of loans* at issue. For instance, the setting of the market rate for automobile loans should be limited to consideration of only the automobile loan universe and not rates that would apply to an average borrower seeking, for instance, financing for a new home.

Furthermore, as noted by the bankruptcy court in *In re Richards*, 243 B.R. 15, 22 (Bankr. N.D. Ohio 1999), the purpose of Chapter 13's cram down provisions is to ensure "that a secured creditor . . . receives payment equal to the vlue of the collateral as of the effective date of the plan." To the extent that the debtor's payments are spread out over time, "the creditor will actually receive less than what he is entitled to due to the simple fact that a sum of money received over [time] does not have the same value as a sum of money received today." *Id.* Hence, in *Memphis Bank & Trust*, we concluded "that current market rates of interest would best approximate the present value of a secured claim." *Id.* Thus, payment of that amount and that amount alone satisfies the purposes of the cram down provisions. In fact, "to permit a secured creditor to receive interest on his claim in an amount greater than the conventional market rates would allow the creditor to actually receive more than the allowed amount of his secured claim." *Id.*

Finally, an analysis of the language used in *Memphis Bank & Trust* clearly negates application of an interest rate

that can be determined only on a case-by-case basis through analysis of information provided and controlled by the creditor. Clearly, the opinion does not anticipate imposition of a rate of interest that would apply in the non-existent "market" that encompasses the factors prevalent in the bankruptcy setting. Rather, by stating that "bankruptcy courts are generally familiar with the current *conventional rates* on various types of consumer loans," *Memphis Bank & Trust*, 692 F.2d at 431 (emphasis added), we directed the use of more generally applicable rates. Moreover, had loan-specific rates been contemplated in formulating the proper interest calculus, there would have been no need to refer to "conventional rates." Indeed, adoption of the position espoused by Household in this appeal would virtually ensure that bankruptcy courts would *not* be familiar with the rates charged by various lenders to different borrowers based upon varied elements of a personal credit history. Rather than conclude that the *Memphis Bank & Trust* court inserted wholly superfluous language into its opinion, we elect to give effect to the carefully chosen terms used in the decision.[1]

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[1] Similarly, had the *Memphis Bank & Trust* court desired to mandate use of an interest rate that would approximate the rate for which the lender would contract, it could easily have used the term "contract rate" in delineating the analysis to be undertaken. Or, as some courts have done, it could have created a presumption in favor of the contract rate as the coerced loan rate. *See, e.g., General Motors Acceptance Corp.*, 999 F.2d at 67-68.

III. Analysis of Bankruptcy Court's Factual Determination of Appropriate Rate

Having reviewed *de novo*, and concurred in, the bankruptcy court's decision to examine "conventional" interest rates in setting the appropriate present value of Household's secured claim, we must now apply the more deferential clear error standard in determining whether the bankruptcy judge's selection of a 10.3% interest rate was proper.

At the evidentiary hearing conducted by the bankruptcy court, testimony was offered that even Household, an admitted sub-prime lender with much higher interest rates than could otherwise be obtained, offered loans at rates as low as 10.95%. Even more germane to the bankruptcy court's final determination, however, was the testimony of a local bank officer who surmised that the weighted average of *all* conventional car loans in the area was 9.3%. Finally, evidence was adduced that only occasionally were objections filed to plans calling for 8% interest rates on automobile loans, "ten and ten and a half don't draw that many objections[,] eleven rarely does and twelve almost never." In light of such information, and considering the fact that no objection was voiced to the finding that interest rates in the relevant vicinity had recently risen, the bankruptcy judge was not *clearly* erroneous in setting a 10.3% interest rate as a "current conventional rate" on consumer automobile loans.[2]

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[2] The creditor also contends that the bankruptcy court, in settling upon an acceptable interest rate, erroneously considered similar rates to which Household had agreed in other Chapter 13 bankruptcies in the months prior to the Kidds' filing. As stated by

CONCLUSION

The principles of valuation espoused in the case of *Memphis Bank & Trust Co. v. Whitman* constitute the law of the circuit and are entitled to precedential deference. In order to give effect not only to the plain wording of that decision, but also to the underlying rationale for the ruling and for the applicable provisions of the Bankruptcy Code, we conclude that the proper interest rate to be applied in a Chapter 13 cram down is the current conventional market rate used for similar loans in the region, and not necessarily the contract rate. Such a determination does not entail an analysis of any particular debtor's credit rating but rather involves a more objective determination of the value of money over time so as to compensate a creditor according to the present value of its secured claim.

Moreover, we conclude that the bankruptcy court did not clearly err in arriving at the 10.3% interest rate figure applied to Household's claim. We therefore AFFIRM the judgment of the district court sustaining the decision of the bankruptcy court.

CONCUR and DISSENT

SIMPSON, District Judge, concurring in part, and dissenting in part. I respectfully dissent from the majority

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the district court in its review of the bankruptcy court ruling, however, this allegation of error need not be addressed on appeal because the other testimony offered at the evidentiary hearing and summarized above was sufficient to support the bankruptcy court's factual determination.

opinion to the extent that it interprets Memphis Bank & Trust Co. v. Whitman[1] to require reference to "more generally applicable"[2] or "conventional"[3] rates of interest which are unrelated to the particular debtor, when determining the appropriate rate of interest for coerced loans in cram-down situations.

Section 1325(a)(5)(B)(ii) states that a plan shall be confirmed if "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." If the secured claim is to be paid over time, the bankruptcy court must assess interest so that the value of the claim is not diluted through delay in payment. The secured creditor is forced to extend a new collateralized loan to the debtor, hence the "coerced" loan concept.[4] *Memphis Bank* mandates that the bankruptcy court determine and apply the current market interest rate for similar loans in the region, not some other unrelated arbitrary rate.[5]

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[1] 692 F.2d 427 (6th Cir. 1982).

[2] Majority Opinion (Maj. Op.), pg. 11.

[3] Maj. Op., pgs. 11-12.

[4] *See, Memphis Bank*, 692 F.2d at 429 ("In effect the law requires the creditor to make a new loan in the amount of the value of the collateral rather than repossess it, and the creditor is entitled to interest on his loan.")

[5] 692 F.2d at 431.

I believe that the application of a generalized rate of interest, in this instance that of the pool of all prime automobile loans, is both arbitrary and a departure from the clear directive of *Memphis Bank*.

The coerced loan is not made in a vacuum, but rather to an actual debtor/borrower, with a discernable degree of predictable risk both as to default and collection/transaction costs. Because such coerced loans are generally without an "equity cushion," the potential for loss to the creditor/lender is even greater. Since *Memphis Bank* requires that what happens in a cram down be viewed as a coerced loan, the bankruptcy court ought to analyze the kind of loan being made so that interest rates on similar loans can be determined. This, in turn, requires consideration of the amount and duration of the loan, as well as the nature of the collateral and the characteristics of the debtor/borrower.

Such an inquiry is faithful to *Memphis Bank* and likely to put the secured creditor in a position very close to what it would have been in had it been allowed to repossess its collateral. The result is that the coerced loan is not made on unrealistic terms either from the creditor's or the debtor's viewpoint. More importantly, the valuation requirements of 11 U.S.C. § 1325(a)(5)(B) are respected because neither party has the possibility of an advantage due to the arbitrary imposition of some generalized interest rate.

Because the loan marketplace will take into account prevailing interest rates and risk factors, the bankruptcy court need only determine what market interest rate would be charged, at the time, on such a loan to such a borrower. The contract, if not too old, may provide evidence of how the

market would price such a loan.

Memphis Bank does not require a loan rate available from the particular creditor to the debtor. Rather, the bankruptcy court ought to determine a market rate bearing some real-world relationship to the coerced loan in issue. Here, the "conventional" rate of interest of 9.3% as determined by the bankruptcy court was based upon an average of all prime automobile loans in the region, for new and used vehicles. But this average did not include the sub-prime loan market in which the original loan had been obtained.[6] There was no showing that the debtors had transformed into prime borrowers. Thus the rate applied was, in fact, an unrelated arbitrary rate. The bankruptcy court's addition of 1% to the 9.3% to account for "special circumstances" described as "recent increases in the prime rate of interest"[7] is arbitrariness on top of arbitrariness.

The majority finds refuge for this result in *Memphis Bank's* observation that "bankruptcy courts are generally familiar with the current conventional rates on various types of consumer loans."[8] The majority converts this dictum into a mandate that only current conventional interest rates can be used for coerced cram-down loans in bankruptcy.

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[6] Joint Appendix, pp. 258, 262-63, 266.

[7] August 14, 2000 Findings of Fact and Conclusions of Law, pg. 3.

[8] 692 F.2d at 431.

While such uniformity is a bit more convenient, it is at odds with reality. The time value of money is not in all cases the same. The fact that the lending market reflects a multitude of interest rates at any one moment is a clear demonstration that the market factors the element of risk into the time value of money. Were it not so, rates for all borrowers would be the same for a given time period, and the availability of credit would be commensurately constrained.

Risk entails many factors. Among them are the likelihood of repayment as revealed by the financial profile of the borrowers, the nature of the collateral, the size of the equity cushion, and the transaction costs attendant to collection of principal and interest.

The generally higher rates of interest charged to sub-prime borrowers account for factors which reduce the odds that the debtor will recover the value of the collateral over time.[9] *Memphis Bank* recognizes that the purpose in assessing interest on the secured portion of the claim is to protect the value of the claim from dilution. To achieve this goal, the element of risk must be factored in more precisely than by simplistically utilizing average interest rates only available to

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[9] *See, In re Glueck*, 223 B.R. 514, 522 (Bankr. S.D. Ohio 1998) ("[A] 'forced loan' of 100 of the value of an automobile is not customary in the industry, and produces additional risks to lenders.") *See also, In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) (listing numerous factors which are utilized by lenders in establishing interest rates).

prime borrowers.[10]

Because the majority approves the imposition of cram-down loan interest rates based on prevailing generalized conventional loan rates, rather than loans similar in quality to the coerced loan itself, I must respectfully dissent.

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[10] Other courts considering the issue raised here have also employed a particularized approach which incorporates market-based factors including, *inter alia*, risk, in determining the appropriate cram-down interest rate. *In re Till*, 301 F.3d 583 (7th Cir. 2002); *In re Smithwick*, 121 F.3d 211 (5th Cir. 1997); *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63 (3d Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); *In re Hardzog*, 901 F.2d 858 (10th Cir. 1990); *United States v. Arnold*, 878 F.2d 925 (6th Cir. 1989); *In re Glueck*, 223 B.R. 514 (Bankr.S.D.Ohio 1998); *In re Cassell*, 119 B.R. 89 (Bankr.W.D.Va. 1990).